

No. 12,814

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Appellant*

v.

P. J. LYNCH, *Appellee*

P. J. LYNCH, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

ON APPEALS FROM THE UNITED STATES DISTRICT
COURT FOR THE EASTERN DISTRICT
OF WASHINGTON

PETITION FOR REHEARING

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Comes now Appellee - Appellant, P. J. Lynch, and petitions the above-entitled Court under Rule 25 of *Federal Rules of Civil Procedure* for a rehearing of said action for the reason that the decision heretofore filed on the 23rd day of November, 1951, is contrary to law. This petition is restricted solely to that portion of the Court's decision relating to the dividend in kind whereby the Court reversed the judgment against the United States of America.

FINDINGS OF FACT

(a) In General

It is submitted that this Court has disregarded the findings of fact made by the lower Court contrary to the general rules relating to the function of an appellate court. In this particular case, the District Court made a finding of fact (Finding of Fact 6, Tr. 13) that "the dividend in kind was a true dividend taxable as income to the stockholders, including plaintiff." The function of the District Court is similar to that of an administrative tribunal, although admittedly there is a distinction between findings made by an administrative tribunal and a district court. In *Commissioner of Internal Revenue v. Court Holding Co.*, 324 U. S. 331, 89 L. Ed. 981, 65 S. Ct. 707, the Court, in discussing a finding made by the Tax Court, which was subsequently denied by the Circuit Court of Appeals, stated:

"There was evidence to support the findings of the Tax Court and its findings must therefore be accepted by the courts. *Dobson v. Commissioner of Internal Revenue*, 320 U. S. 489, 88 L. Ed. 248, 64 S. Ct. 239; *Commissioner of Internal Revenue v. Heininger*, 320 U. S. 467, 88 L. Ed. 171, 64 S. Ct. 249; *Commissioner of Internal Revenue v. Scottish American Invest. Co.*, 323 U. S. 119, ante, 97, 65 S. Ct. 169."

In the *Scottish American* case, *supra*, the Tax Court made a finding that a particular office was not a sham, but was used for regular transaction of business thus making the taxpayers resident foreign corporations. The Circuit Court

denied this finding. Justice Murphy writes as follows in the decision:

“The sole issue revolves about the propriety of the inferences and conclusions drawn from the evidence by the Tax Court. The taxpayers claim that these determinations are supported by substantial evidence and hence were not reversible by an appellate court. . . .

“The answer is to be found in a proper realization of the distinctive functions of the Tax Court and the Circuit Courts of Appeal in this respect. The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence, and choosing from among conflicting factual inferences and conclusions those which it considers most reasonable. The Circuit Courts of Appeal have no power to change or add to those findings of fact or to reweigh the evidence. And when the Tax Court’s factual inferences and conclusions are determinative of compliance with statutory requirements, the Appellate Courts are limited to a determination of whether they have any substantial basis in the evidence. . . . If a substantial basis is lacking the Appellate Court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for further appropriate proceedings. But if such a basis is present the process of judicial review is at an end.”

and at page 125:

“We do not decide or imply that the contrary inferences and conclusions urged by the Commissioner are entirely unreasonable or completely unsupported by any probative evidence. We merely hold that such contentions are irrelevant so long as there is adequate support in the evidence for what the Tax Court has inferred. It follows that the Tax Court’s conclusions in this case cannot be set aside on appellate review.”

Although the rule is not as strict as to District Courts,

the determination of the binding effect of a finding is similar. Rule 52(A) of the *Federal Rules of Civil Procedure* recites as follows:

“Findings of fact shall not be set aside unless clearly erroneous.”

This rule has been interpreted in numerous cases to mean that the findings by the District Court are binding on appeal if the records offer an adequate basis for the conclusions and inferences drawn by the District Court, (*U. S. v. Cold Metal Process Company*, 164 F. 2d 754); and the Reviewing Court’s power is limited to a determination of whether the inferences and conclusions of the trial judge in making findings of fact have any substantial basis in evidence, and if such basis is present, the findings of the Trial Court must be accepted. *Gaytime Frock Company v. Liberty Mutual Insurance Company*, 148 F. 2d 694. Even though different reasonable inferences may fairly be drawn from the evidence and even though the District Court might well have reached a different conclusion, the Appellate Court should not disturb the findings of the District Court unless they are clearly erroneous. *Tennessee Coal, Iron & R. Company v. Muscoda Local No. 123*, 137 F. 2d 176; *Bostian v. Levich*, 134 F. 2d 284. In determining whether the District Court’s findings are “clearly erroneous,” appellee must be given the benefit of all favorable inferences, which reasonably may be drawn from the evidence. *Cashman v. Mason*, 166 F. 2d 693. The findings of the District

Court, which are supported by evidence or which are based upon reasonable inferences drawn from evidence are not "clearly erroneous." *Gray, McFawn & Co. v. Hegarty Conroy & Co.*, 109 F. 2d 443; *Reynolds Metal Co. v. Skinner*, 166 F. 2d 66.

It is submitted that in the instant case the finding by the District Court that the dividend in kind was a true dividend has substantial basis in the evidence and that a view of all of the evidence from the standpoint most favorable to appellee-appellant of necessity indicates that the finding is not "clearly erroneous." For this reason, the finding should be binding upon this Court and the setting aside of that finding should be held in error.

(b) Specific Findings of This Court

It is further submitted that this Court has misunderstood the facts and that apparently, from the decision, such misunderstanding was considered important in the final determination. An example of this is shown on page 2 of the *Decision*, wherein it is stated that the property distributed by the corporation represented its inventory or stock in trade. This is completely wrong. The testimony shown at the trial was to the effect that the corporation normally handled the fruit owned by other persons by storing, preparing for market and marketing. The apples, which were involved in the dividend had been purchased by the corporation from other owners and although such practice did occur, this practice was not the normal method

of operation and did not represent the bulk of the company's business.

Secondly, the Court recites on page 3 of the *Decision*:

“Distribution of corporate inventory with the expectation of the immediate sale by the shareholders pointedly suggests a transaction outside the range of normal commercially motivated and justifiable corporate activity.”

An understanding of the apple industry and a reading of the transcript indicates that a sale within the immediate future was probable, due to the peculiarities of the apple industry. Admittedly, as compared with some years, a sale of the fruit involved in the dividend was not difficult, there being a good market. Such a condition exists today, whereas during the years 1949 to 1950 the condition was not present. However, the probable sale within the immediate future should not be used as an excuse to deny the validity of the dividend. (See *Ripy Brothers Distilleries, Inc. v. Commissioner of Internal Revenue*, 11 T. C. 326, as set forth in Appellee-Appellant brief).

THE LAW

On page 3 of the *Decision*, the Court states:

“Under these circumstances, we fail to see a motive for the dividend other than to escape taxation.”

Thereafter the Court makes use of *Commissioner v. Transport Trading and Terminal Corporation*, 176 F. 2d 570, to sustain the theory that the presence of such a motive denies

the validity of the dividend. The key and most important case upon this point is *Gregory v. Helvering*, 293 U. S. 465, 79 L. Ed. 596. It is submitted that the Court has disregarded the Gregory decision and the correct approach to this problem. In the Gregory case, the question arose as to whether a reorganization had been accomplished from the tax standpoint. At page 468 the Supreme Court, through Mr. Justice Sutherland, states:

“It is earnestly contended on behalf of the taxpayer that since every element required by the foregoing subdivision (B) is to be found in what was done, a statutory reorganization was effected; and that the motive of the taxpayer thereby to escape payment of a tax will not alter the result or make unlawful what the statute allows. It is quite true that if a reorganization in reality was effected within the meaning of subdivision (B) the ulterior purpose mentioned will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes or altogether avoid them, by means which the law permits, cannot be doubted.”

The Court then says that the question to be determined is whether a reorganization actually occurred. The distinction drawn by the Court is found in its statement as to what occurred:

“Simply an operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. No doubt, a new and valid corpora-

tion was created. But that corporation was nothing more than a contrivance to the end last described. It was brought into existence for no other purpose; it performed, as it was intended from the beginning it should perform, no other function. When that limited function had been exercised it immediately was put to death."

Applying this to the instant case, we find that the motive to escape or reduce taxes is proper and may be disregarded in determining whether the dividend was in truth a dividend. The sole determination is whether the dividend as declared and accomplished had a proper business motive. The normal business motive in the declaration of the dividend is the transferal of corporate assets to stockholders in the proportion of their holdings to provide such stockholders a return on their investments from corporate earnings. This was accomplished in the instant case by the transferring to the stockholders, apples which had been purchased by the corporation from its earnings. *The mere fact that income taxes were materially reduced by the use of this procedure and the fact that such was contemplated in the declaration of the dividend is immaterial.* As stated in *U. S. v. Cumberland P. S. Company*, 338 U. S. 451, 94 L. Ed. 251:

"While the distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held, Congress has chosen to recognize such a distinction for tax purposes."

and later in the same opinion:

“The oddities in tax consequences that emerge from the tax provisions here controlling appear to be inherent in the present tax pattern. For a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet is not taxed if that property is distributed in kind and is then sold by the shareholders. In both instances, the interest of the shareholders in the business has been transferred to the purchaser. . . .

“Congress having determined that different tax consequences shall flow from different methods, by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate. It is for the trial court upon consideration of an entire transaction to determine the factual category in which a particular transaction belongs.”

It is submitted that the Gregory decision, *supra*, and the Cumberland decision, *supra*, contain the proper rules applicable to the instant case and fully demonstrate that the Trial Court was correct in making its findings that the dividend in kind was a true dividend.

The Court on page 2 of its *Decisions* states that the Trial Courts finding was clearly erroneous because the dividend was not and was not intended to be a liquidating dividend. Appellee - Appellant presents the Ripy case, *supra*, as one of the most recent and well considered decisions sustaining the view that a dividend in kind is proper in a going concern without the tax consequences to the corporation, which this Court has ruled. *There is no rule of law that a dividend in kind, to be a true dividend from*

the tax standpoint, has to be a liquidating dividend and Appellee-Appellant submits that such does not make the lower Court's finding clearly erroneous.

CONCLUSION

It is respectfully submitted to the Court that:

1. The finding of the Trial Court that the dividend in kind was a true dividend, was supported by the evidence and thus not clearly erroneous.
2. The doctrine of the Gregory case has not been correctly applied in the Transport Trading case nor in the instant case.
3. The motive of decreasing taxation is a valid one and does not make taxable that which is not.
4. Appellee-Appellant Lynch should be granted a rehearing, and upon such hearing the former decision of this Court should be set aside as to the dividend in kind issue, and the decision of the Trial Court should be affirmed.

Respectfully submitted,

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